

PROGRAM EVALUATION REPORT

WEST VIRGINIA

Drinking Water Treatment Revolving Fund

STATE FISCAL YEAR 2005

FINAL

July 2006

**U.S. Environmental Protection Agency
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Philadelphia, PA**

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PROGRAM EVALUATION REPORT

West Virginia

Drinking Water Treatment Revolving Fund

State Fiscal Year 2005

EXECUTIVE SUMMARY

This Program Evaluation Report (PER) is the U.S. Environmental Protection Agency (EPA) evaluation of the West Virginia Bureau of Public Health's (BPH's) Drinking Water Treatment Revolving Fund (DWTRF) program. The report identifies strengths and areas for improvement in the program. The review covers the period July 1, 2004 through June 30, 2005. EPA conducted its on-site review from April 4 to 6, 2006.

The process included the submittal of the BPH Biennial Report, EPA's evaluation of the program, and EPA's issuance of this PER.

The scope of this year's program review was established in accordance with EPA's Interim Final Annual Review Guidance and the national State Revolving Fund (SRF) Checklist to ensure a detailed review of all program components.

BPH is managing the DWTRF program effectively and efficiently. The program exhibits sound financial strength, including:

- Strong accounting and financial structure;
- Good financial capability review and loan monitoring processes;
- Annual independent and periodic internal financial and compliance audits; and
- Prudent investment policies.

The State met the binding commitment (BC) requirement during FY 2005. EPA commends BPH for taking steps to increase program pace and for making DWTRF loans to small systems and disadvantaged communities. Nevertheless, BPH still lags far behind the national average for loan closings as a percentage of total funds available.

The PER recommends that BPH:

- Include one or more success stories in future Biennial/Interim Annual Reports.
- Prepare a brief report which: (1) analyzes the factors which impact the pace of loan execution and the fund utilization rate and (2) identifies recommendations for how to improve performance.
- Include in future set-aside workplans schedules and budgets for each activity over a period not to exceed four years.
- Compare actual set-aside expenditures and deliverables to projections included in DWTRF set-aside workplans and include this analysis in future drinking water semi-annual progress reports and Interim Annual/Biennial Reports.
- Confirm the cumulative amounts obligated and expended for the Program Management set-aside as of June 30, 2005.
- Enter data for all compliance categories for all DWTRF loans, both for the current reporting cycle and for all loans made in past years, no later than the FY 2006 DWNIMS data entry period.

The State should implement these action items as soon as practicable. In addition, the State should promptly respond to outstanding action items identified in the FY 2004 PER (see page).

INTRODUCTION

This PER is the EPA evaluation of West Virginia's DWTRF program. A PER documents the annual review process, as required by the Safe Drinking Water Act (SDWA).

The purpose of an annual review is to assess the State's management of the program, including:

- Performance in achieving goals and objectives identified in the Intended Use Plan (IUP) and Biennial Report;
- Compliance with the terms of the capitalization grant agreement, operating agreement, and regulations;
- Financial status and performance of the Funds and set-aside accounts;
- Status of resolution of prior year PER action items;
- Correction of audit findings and recommendations; and
- Discussion of future program directions and initiatives.

This PER identifies strengths and areas for improvement in the program. The annual review covered the period July 1, 2004 through June 30, 2005. EPA conducted its on-site review from April 4 to 6, 2006.

The annual review process included BPH's submittal of the Biennial Report, EPA's evaluation of the State's program, and the issuance of this PER. EPA conducts separate reviews of the technical aspects of the drinking water program activities undertaken with set-aside funds. In addition to the progress of set-aside activities, the broader drinking water program review also covers activities conducted under the Public Water System Supervision (PWSS), water security, and operator expense reimbursement grants. The current DWTRF review examined the administrative and financial aspects of the set-aside activities.

BACKGROUND

The SDWA Amendments of 1996 authorized funding for states to establish a Drinking Water State Revolving Fund (DWSRF) program to assist systems to finance the cost of infrastructure needed to achieve or maintain compliance with SDWA requirements and to protect public health. The DWSRF program includes both construction funds and set-aside funds for support of state-wide drinking water program support activities.

Under Title 64 of the West Virginia Code, BPH is responsible for implementing and managing the DWTRF program in accordance with the requirements and objectives of SDWA. The program resides in the Department of Health and Human Resources (DHHR), which provides management for SRF financial matters, including grants management and disbursement of funds. Additional coordination with offices of the State Treasurer and the State Auditor ensure inter- and intra-agency coordination, management and oversight as well as program integrity.

In addition to the DWTRF construction fund, BPH administers several set-aside (or non-project) accounts used for: (1) administration of the loan program, (2) small system technical assistance, (3) state program management, and (4) local assistance and other state activities.

Some of the goals of the DWTRF include:

- Provide financial assistance to eligible drinking water systems to eliminate drinking water problems and improve drinking water quality in the State;
- Continue implementation of the Source Water Protection Plan through community and non-community ground and surface water assessments;
- Continue implementation of the Capacity Development Strategy, assisting existing and newly created public water supplies in acquiring and maintaining capacity to comply with SDWA; and
- Market and develop the DWTRF to ensure the long term health of the fund.

As of June 30, 2005, total capitalization for the DWTRF project fund and set-aside program activities is \$70,495,920, which consists of Federal grant funds and state match. During FY 2005, BPH closed five loans for a total of \$5,334,000.

SCOPE

The FY 2005 annual review of West Virginia's DWTRF program was conducted in accordance with EPA's SRF Interim Final Annual Review Guidance to ensure a detailed review of all program components.

The programmatic review included the following topics:

- Public health benefits,
- Program pace,
- Funding to small and disadvantaged communities,
- IUP goals,
- Compliance with Federal cross-cutting requirements,
- Operating Agreement (OA),
- Government Performance and Results Act, and
- Sustainability/asset management.

The grant compliance review included the following requirements:

- Acceptance of payments,
- State match,
- Binding commitments,
- Financial Status Reports (FSRs),
- Federal Cash Transaction Reports (FCTRs),
- Administrative costs,
- Data management, and
- Biennial Report.

The financial review included the following matters:

- Financial health of the Fund,
- Perpetuity,
- Financial indicators,
- Audits,
- Loan monitoring,
- Collections on loans receivable,
- Financial management policies, and
- Capability assessment system.

To accomplish the review, EPA:

- Held discussions with State staff.
- Reviewed the following documents:
 - Biennial/Interim Annual Report,
 - IUPs,
 - Project Priority Lists,
 - Data in the Drinking Water National Information Management System (DWNIMS) database,
 - FSRs,
 - FCTRs and
 - EPA grants payment records.
- Reviewed the following project files:
 - Gilmer County Public Service District (PSD), and
 - City of Kenova.
- Reviewed the following financial files:
 - Cowen PSD,
 - New Haven PSD,
 - Danville PSD (Boone County),
 - Town of Delbarton, and
 - Town of Franklin.

EPA conducts separate reviews of the technical aspects of the drinking water program activities undertaken with set-aside funds in conjunction with its review of the PWSS program. The current review examined the administrative and financial aspects of the set-aside activities.

In addition, as part of the annual review, EPA followed up on the action items included in the FY 2004 PER. EPA will follow up on any unresolved action items subsequent to issuance of the PER and, as appropriate, during the FY 2006 annual review.

OBSERVATIONS PROGRAMMATIC AREAS REVIEWED

PUBLIC HEALTH BENEFITS

The State briefly describes the expected public health benefits of drinking water projects in its IUPs and Biennial/Interim Annual Reports. The State's 2005 Annual Report included project descriptions for the Gilmer County PSD and Cowen PSD projects which addressed a variety of drinking water problems. There was, however, insufficient detail in the project descriptions to serve as success stories. The Annual Report did include an acceptable success story related to the Shepherdstown project, but that information had been included in EPA's FY 2004 PER. Subsequent to the annual review, BPH provided additional information for the Gilmer County PSD and Cowen PSD projects.

Gilmer County PSD

The Gilmer County PSD is located in central West Virginia. It was created in 1995 and purchases all of its water from the Town of Glenville. The PSD distributes water throughout Gilmer County for 236 existing customers. The purpose of the current DWTRF project is to extend water to the Normantown and Stumptown areas of the County to serve residents who have an inadequate drinking water supply and poor quality water. In addition, the project will (1) allow the closure of a private well supplying water to the Normantown Elementary School, (2) provide water to Cedar Creek State Park, and (3) provide service to an additional new 131 residential customers, taking two poorly performing systems offline.

This project benefits the residents and school children by providing safe, reliable, contaminate-free public water. The Normantown Elementary School had its own water system and utilized a groundwater well to produce potable water which supplied water to 163 children and 24 full and part-time staff. A sanitary survey of the system conducted in April of 1998 and the chemical analysis of the water indicated levels of iron and manganese above the secondary contaminant levels.

The project extension consists of the installation of 75,000 linear feet of six-inch water line and the construction of two 50,000 gallon water storage tanks. A 100-gpm pump station will be installed to deliver water to the extension area and allow for the consolidation of three systems into one.

The project was funded by a \$1,639,000 zero percent DWTRF loan for 30 years and a West Virginia Infrastructure Jobs and Development Council (IJDC) \$1,470,000 zero percent loan for 40 years. The total cost of the project is \$3,109,000.

Cowen PSD

The Cowen Public Service District (PSD) serves a population of 2,306 residents (923 customers) in and around the Town of Cowen in Webster County, which is a steep, mountainous part of West Virginia. The water treatment plant upgrade/extension project will enable the PSD to provide a reliable source of potable water for the local residents and to comply with SDWA requirements. The project will allow the PSD to continue to serve current customers and meet the needs of new customers.

The existing water treatment plant did not comply with the turbidity requirements under the SDWA Long Term 1 Enhanced Surface Water Treatment Rule (LT1ESWTR). The PSD did not have in-line turbidity monitoring in place. The filter-to-waste piping discharged directly into the river, without treatment. The operations staff had not used the discharge piping for many years. The filter effluent turbidity did not comply with the LT1ESWTR more than 40 percent of the time. After the filter was placed on line after a backwash, one of the filters spiked to levels which exceeded the allowable turbidity standards by a factor of ten.

Portions of the service area suffered from poor quantity and quality water, due to suspected fecal contamination. None of the water storage tanks were fenced.

The treatment plant portion of the project included an upgrade and expansion of the existing 320 gallon per minute (GPM) water treatment plant to a 450 GPM plant. Major improvements to the plant include: (1) replacement of the existing raw water pumps, (2) replacement of the existing filters with dual media (silica sand and anthracite) filters, and (3) installation of a backwash system and a new header/lateral underdrain system. The plant upgrade also included: (1) replacement of the existing high service pumps, (2) addition of a new chlorination/dechlorination building, (3) addition of a new telemetry system and controls; (4) replacement of the existing filter float valves with controls, (5) upgrade of the existing power system, (6) and installation of necessary valves, controls, and appurtenances. The project also included security measures at all of the PSD's treated water storage facilities including fencing, access hatch locks, and related equipment to deter access by unauthorized persons.

The extension portion of the project consisted of installation of: (1) 8-inch and smaller water lines, (2) two pressure reducing stations, (3) one booster station, (4) a storage tank, and (5) necessary valves, controls, and appurtenances.

With the completion of the project, the in-line turbidimeters were in place and operational. The water treatment plant has met the LT1ESWTR requirement 100 percent of the time. The treatment plant is making strides toward meeting the Areawide Optimization Program goals. The project has been crucial to the PSD's compliance with the treatment and monitoring requirements of the LT1ESWTR. The residents in

the extension area, as well as throughout the system, have drinking water which meets safe drinking water standards. All of the PSD's storage tanks have security fencing.

The project was funded by a \$1,200,000 DWTRF loan (two loans - one zero percent interest for 30 years and another at three percent interest for 20 years), an Appalachian Regional Commission grant for \$833,000 and a U.S. Department of Housing and Urban Development Small Cities Block Grant for \$1,100,000. The total cost of the project was \$3,133,000.

Action Item: BPH shall include one or more success stories in future Biennial/Interim Annual Reports.

PROGRAM PACE

BPH closed five drinking water loans totaling \$5,334,000 during the year ending June 30, 2005. The BC requirement obligates a state to enter into agreements with loan applicants to provide assistance for an amount at least equal to 120% of a Federal grant payment within one year of the state's receipt of the payment. EPA uses compliance with the BC requirement as one measure of the State's ability to commit DWTRF funds in a timely and expeditious manner. The State met the BC requirement during FY 2005. EPA also uses the fund utilization indicator (i.e., closed loans as a percentage of total funds available) as a measure of program pace. BPH's fund utilization rate is 63%, which is substantially lower than the national average of 86%. (See further discussion of program pace on page and of BCs on page .)

Steps the State has taken to address pace and BC compliance include:

- Installing the Northbridge project tracking system;
- Providing quarterly BC and loan closing status reports to EPA;
- Increased marketing; and
- Improvements to the priority list development process.

Project Tracking

The project tracking system will enhance BPH's program oversight capabilities and allow the State to identify follow-up dates to ensure that applications are progressing. The system will be an important program management tool because it will allow BPH to identify delays in all phases of project management (including the time between issuance of BC letters and loan closings) and to implement measures to move projects through the process more quickly. The tracking system will also enable BPH to enter data directly into DWNIMS.

Marketing

BPH took several steps to market the DWTRF program during FY 2005, including:

- Presentations at the West Virginia Rural Water Association Conference and the West Virginia IJDC meetings;
- A display at the annual West Virginia EXPO for engineers and consultants;
- Articles in the West Virginia and National Rural Water Association magazines;
- Outreach to water treatment operators using the BPH and Public Service Commission Newsletters; and
- A 12-month training calendar for water treatment operators in conjunction with the West Virginia Drinking Water Education and Training Coalition.

Priority List Development

BPH screens all water projects for the IJDC, the State's funding clearinghouse. Until FY 2005, BPH used the IJDC loan application to identify and rank potential DWTRF loan applicants. As a result, projects on BPH's project priority list either had not expressed specific interest in DWTRF loans nor had all necessary funding in place, causing significant delays in the loan closing process. To remedy this, BPH has developed a separate application to generate the DWTRF project priority list. The State's goal is to accelerate the readiness of projects to proceed to loan closing and construction.

These efforts are expected to show positive results during State FY 2006. However, for the period covered by the review, the State's performance on the pace indicator is far below the national average.

The State has committed to preparing a report of ways to accelerate program pace and streamline the loan application and closing process as requested in the FY 2004 PER. BPH has initiated, but has not completed this effort. EPA commends BPH for its efforts to improve BC compliance and increase its fund utilization rate.

Action Item: BPH shall prepare a brief report which: (1) analyzes the factors which impact the pace of loan execution and the fund utilization rate and (2) identifies recommendations to improve performance.

SMALL AND DISADVANTAGED ASSISTANCE

BPH has done an excellent job of meeting the needs of small and disadvantaged drinking water systems and has exceeded the SDWA minimum requirement to provide 15% of available funding to small systems (less than 10,000 population). As of June 30, 2005, the State provided 26 DWTRF loans in the amount of \$28,486,908 to small communities, or 74% of total loan dollars. This exceeded the national average of 39% of funding to small systems, placing BPH among the top ten states in small system funding. BPH also provided 20 loans in the amount of \$23,105,867 to disadvantaged systems, representing 60% of total loan dollars. The State's terms for disadvantaged communities include a minimum interest rate of 0% and repayment terms of up to 30 years. The State does not offer principal forgiveness.

OPERATING AGREEMENT

BPH prepared proposed amendments to the Operating Agreement (OA) and provided them to EPA during the annual review.

Action Item: EPA will review BPH's proposed amendments to the OA.

DISADVANTAGED BUSINESS ENTERPRISES (DBE)

EPA issued supplemental DBE guidance on December 8, 2005. An action item in the FY 2004 PER required BPH to submit a plan to EPA for DBE implementation within 60 days of the State's receipt of the guidance. BPH submitted its DBE plan on February 8, 2006 and subsequently responded to EPA's comments on the plan. The State's plan is acceptable.

Because the DBE guidance was not finalized until FY 2006, EPA did not conduct a file review of compliance with DBE requirements as part of the FY 2005 annual review.

ENVIRONMENTAL REVIEW

EPA reviewed the State's files for the Gilmer County PSD and the City of Kenova drinking water projects which completed the State Environmental Review Process (SERP) during Fiscal Year 2005. BPH issued a Finding of No Significant Impact for each of these projects, consistent with the SERP. The State also developed a cross-cutter checklist which it uses to document compliance with each cross-cutter; this checklist facilitated EPA's file review.

SET-ASIDE ACTIVITIES

The table below shows the State's progress in obligating and expending funds on a cumulative basis for each set-aside category. As of June 30, 2005, the national cumulative average rates of state set-aside expenditures were 65.5% for Technical Assistance, 68.8% for Program Management, and 60.3% for Local Assistance. The table shows that BPH's cumulative expenditure rate is higher than the national average for the Technical Assistance and Program Management set-aside categories and only slightly below the national average for Local Assistance. Overall, BPH's expenditure rate for Federally provided set-aside funds is 81.1%, exceeding the national average of 62.4%.

EPA does not have information on expenditures by individual activities within set-aside categories. EPA wishes to obtain a better understanding of which specific set-aside activities may have fallen behind schedule. Such an analysis would compare approved workplans to state progress reports of completed set-aside work. The Region released draft supplemental guidance to the states on March 1, 2006. The draft guidance identifies additional information for states to include in the DWSRF capitalization grant application set-aside workplans. The Region's guidance also clarifies EPA's expectations regarding state set-aside reporting in the semi-annual drinking water progress reports and the DWSRF Interim Annual/Biennial Reports. The set-aside workplans do not currently provide sufficient detail regarding budgets and schedules for individual set-aside activities to meet EPA's needs. As a result, EPA has not been able to compare actual to planned set-aside work accomplishments and spending.

EPA will provide guidance to BPH requesting: (1) additional detail in future set-aside workplans regarding budget and schedule for activities in each set-aside category and (2) analysis and reporting of the actual vs. planned set-aside expenditures and accomplishment of deliverables by activity.

BPH provides its Program Management set-aside match in cash. While the expenditure rate for Program Management shown (100%) reflects full utilization of Federal funds, BPH has also expended state match funds so that the State has actually expended 134.4% of Federal funds, nearly twice the national average (68.8%). On a cumulative basis, BPH reports that it has obligated \$7,082,907 for Program Management activities, which exceeds the Federal funds provided for this set-aside by \$1,967,605. The amount above the Federal funds reflects obligation of a portion of the available state match. The State has committed a total of \$5,115,302 in matching funds for the Program Management set-aside. BPH reported that it had expended \$7,314,892 for the Program Management set-aside, which exceeds the Federal funds for this set-aside category by \$2,199,590. The State reported cumulative expenditures of \$7,058,514 for this set-aside category in DWNIMS as of June 30, 2005. Note that

set-aside expenditures cannot exceed the amount obligated. The State should also confirm the amount expended.

SET-ASIDE UTILIZATION FOR ALL GRANTS Cumulative As of June 30, 2005				
	Technical Assistance	Program Management	Local Assistance	Total
CUMULATIVE AWARDED	\$1,162,653	\$5,115,302	\$6,570,291	\$12,848,246
CUMULATIVE OBLIGATED	\$1,145,118	\$7,082,907	\$3,933,596	\$12,161,621
% OBLIGATED	98.5%	138.5%	59.9%	82.0%
*EXPENDED	\$1,091,757	\$7,314,892	\$3,917,762	\$12,324,411
% EXPENDED	93.9%	100.0%	59.6%	81.1%
% EXPENDED U.S. Average	65.5%	68.8%	60.3%	62.4%

*Source: DWNIMS

Further analysis of the State's progress in expending set-aside funds will be conducted as part of EPA's drinking water program oversight process.

Action Items: EPA shall revise and release the supplemental Regional set-aside management guidance.

In accordance with the EPA Regional supplemental set-aside guidance, the State's future set-aside workplans will include schedules and budgets for each activity over a period not to exceed four years.

In accordance with the EPA Regional supplemental set-aside guidance, the State will compare actual set-aside expenditures and deliverables to projections included in DWTRF set-aside workplans. The State shall include this analysis in future drinking water semi-annual progress reports and DWTRF Interim Annual/Biennial Reports.

BPH shall confirm the cumulative amounts obligated and expended for the Program Management set-aside as of June 30, 2005.

Technical Assistance

During state fiscal year 2005, BPH provided 168 continuing education hours for drinking water system operators. Through contract the State provided one-week training and one-day refresher training classes for cross-connection control and backflow prevention for small system operators. Under contract with the West Virginia Rural Water Association, the State provided public education in schools, teaching children about drinking water.

Program Management

The State continued to provide assistance and advice to concerned citizens via public meetings, residential visits, phone calls, and other means. The State provided information packages to the public and participated in sanitarian training on cross-connection and backflow prevention. BPH increased the use of SDWIS/State for sharing information with Federal, state and local partners. BPH continued to provide certification and continuing education training courses for drinking water operators as well as training for surface water system operators in support of the Area Wide Optimization Program on how to optimize treatment plant performance. The State worked with systems to address findings from the capacity development assessments. The State compared scoring from previous capacity development baseline studies and found that water systems that received assessments showed more improvement than systems that did not receive an assessment.

Local Assistance

BPH conducted 13 assessments of water systems and issued reports to these systems. The State completed and submitted to EPA the Report to the Governor on the efficacy of the capacity development strategy and progress toward improving the capacity of water systems. The State has completed all source water assessments for community and non-community public water supply systems.

OBSERVATIONS FINANCIAL AREAS REVIEWED

HEALTH OF THE FUND

Capitalization grants and state match earmarked for the DWTRF as of June 30, 2005 totaled \$70,495,920. The overall financial growth of the DWTRF has been good due to the continuation of EPA grants and state match funding. As of June 30, 2005, net assets of the DWTRF loan fund were approximately \$39,496,080, not counting unexpended Federal capitalization grant funds. That is 13 percent over FY 2004 net assets of \$34,926,745. Net assets include \$37,518,587 in EPA grants and state match, \$1,977,493 in loan and investment interest, and \$35,566 in user fees received. Net assets reflect the subtraction of Water Development Authority (WDA) administrative expenses as of June 30, 2005. Most of the growth in net assets was from the EPA grants and state match.

The financial health of the West Virginia DWTRF program is good. All loans are secured by system revenues and reserves pledged by the borrowing entities. The DWTRF fund account has a strong cash flow. Financial management is sound, the State's internal controls are in place, there is no debt, and there have been no loan defaults. A summary of the financial status of the DWTRF program is shown below:

Financial Health Summary As of June 30, 2005	
Cumulative Federal Grants & State Match	\$70,495,920
Net Assets	\$39,496,080
Loan Repayments	\$4,287,309
Investment Earnings	\$1,087,519
User Fees	\$35,566
Loan Disbursements	\$33,155,186

DWTRF funds are invested by the State Treasurer in the Cash Liquidity and Government Money Market Pools managed by the West Virginia Investment Management Board (IMB). These pools were established by the State to provide for the investment of State and local government funds. The types of securities in which IMB invests include U.S. Government obligations, repurchase agreements, highly-rated corporate bonds and commercial paper. These securities are considered to be among

the safest available. U.S. Government obligations are secured by the full faith and credit of the U.S. government. The corporate bonds and other securities achieve their high ratings because they are not likely to default. IMB repurchase agreements are collateralized by U.S. treasury securities at 102 percent of principal.

Return on Equity (ROE) is a measure of the growth of capital within the DWTRF. The ROE for the DWTRF was 1.22% for FY 2005, which is an increase of 0.17% over ROE for FY 2004 (1.05%). An ROE of 1.22% for a subsidized lending program that issues loans with rates between 0 and 2% is not unexpected; however, it will not maintain purchasing power when inflation exceeds 1.22%.

One way for BPH to determine the effect of inflation on the DWTRF would be to prepare long-term financial projections for the DWTRF based upon current financial policies (e.g., interest rates, loan term, construction period interest). These projections could be compared to the same parameters discounted by the anticipated rate of inflation over the same time period. EPA will provide assistance in preparing these projections using the EPA Financial Planning Model if requested by BPH.

FINANCIAL INDICATORS

The State is far below the national average on the program pace measure. Funds are not being committed to loans commensurate with EPA expectations. On other financial indicators the DWTRF program's financial performance is adequate. The State maintains lending capacity to provide financial assistance into perpetuity. The rate of growth above initial Federal and State contributions is small; however, it is higher than the national average. Note that each of the indicators on the following table reflects calculations on a cumulative basis.

NIMS Financial Indicators for DWTRF				
Indicator	2003	2004	2005	National Average
Program Pace (Loans as a % of Funds Available)	68%	63%	63%	86%
Return on Federal Investment	134%	134%	138%	173%
Disbursements as a % of Assistance	87%	88%	86%	75%
Net Return After Forgiving Principal	\$1,156,919	\$1,464,985	\$1,882,647	--
Net Return on Contributed Capital	4.3%	4.7%	5.5%	2%

Program Pace (Loans as a % of Funds Available)

The Loans to Funds Available indicator represents the percent of money available in the DWTRF program which has been lent. The Loans to Funds Available indicator reflects executed loans. It is far below the national EPA benchmark of 86%. EPA expects that the on-going study will result in implementation of program changes which substantially increase the State's pace of loan issuance. (See page 12.)

EPA's Strategic Plan includes a program activity measure on "Fund Utilization" which is comparable to the program pace indicator reported in DWNIMS. The 2005 Strategic Plan included a national target of 81% and a Region 3 commitment of 79%. The Agency's 2006 National Water Program Guidance, which implements and updates the Strategic Plan, includes an FY 2008 national target of 86%. Region 3 is developing its related 2008 target for this measure. For FY 2006, the EPA commitments for this measure are national, 82.4% and Region 3, 83%. BPH committed to achieving 65% pace in FY 2006.

Return on Federal Investment

The Return on Federal Investment indicator shows the amount of financial assistance or loans disbursed for each dollar of Federal cash draws made on a cumulative basis. The national average for this indicator is 173%. The national average for this indicator for states which have leveraged is 215%; for non-leveraged states it is 128%. For the period covered by this review, the State's performance (138%) was higher than the national average of non-leveraged states and, therefore, is acceptable.

Disbursements as a Percentage of Assistance

Loan Disbursements as a Percentage of Assistance Provided shows the speed at which funds are disbursed to closed loans. It is calculated by dividing cumulative loan disbursements by cumulative assistance provided. The value of the indicator ranges from 0% to no more than 100%. BPH (86%) is above the national average (75%). This shows that, although BPH is not closing loans at the expected pace, when it closes loans, BPH is very timely in disbursing funds and completing projects.

Net Return after Forgiving Principal

Net Return after Forgiving Principal, also called Net Return, shows the net earnings of the DWTRF after loan principal has been forgiven. The operating earnings are calculated first by subtracting the net bond interest expenses. Match bond principal and loan principal forgiven are then subtracted from these earnings to yield the net return to the DWTRF. (West Virginia does not issue bonds to generate its match, nor does it provide loan principal forgiveness.) The Net Return indicator shows how well the DWTRF is maintaining invested or contributed capital. Note that performance is

expected to be a net positive return. The net return increased by over 26% from 2003 to 2004, and by 28% from 2004 to 2005, which is acceptable.

Net Return on Contributed Capital

Net Return on Contributed Capital gives context to the Net Return indicator by comparing the net return of the DWTRF to the dollar amount of contributed capital. It is calculated by dividing the Net Return by cumulative contributed capital and expressed as a percentage. Another way of stating this rate is that as of June 30, 2005, the DWTRF returned approximately \$1.06 for each dollar of contributed capital invested. Contributed capital is equal to total Federal cash draws less set-aside expenses plus state match deposited into the DWTRF. BPH has a net return on contributed capital that is above 0% and above the national average of 2%. This indicates that the DWTRF is accumulating capital on the initial EPA and State contributions, which is acceptable.

AUDITS OF THE FUND

On August 3, 2005, the independent certified public accountants (CPAs) issued their opinion on the DWTRF audited financial statements which include the State construction loan portion of the BPH DWTRF. The auditors expressed an unqualified opinion on these financial statements, indicating that they are fairly presented and conform to generally accepted accounting principles.

As part of their audit, the CPAs performed a single program audit of the State's Federal financial assistance in accordance with generally accepted governmental auditing standards and Office of Management and Budget (OMB) Circular A-133 and issued that report on the same date as the financial statements. There were no notes or disclosures indicating any deficiencies in the State's accounting system or internal controls. The audit, however, contained one finding of non-compliance with Federal regulations as follows:

“2005-1 Sub-recipient Monitoring

Fiscal Year Ending (FYE) June 30, 2004: 4 sub-recipient audits with continuing compliance requirements were not received as of the date of the audit report.

FYE June 30, 2003: 2 required Single Audits from sub-recipients were not received as of the date of the audit report. This remains unchanged from the prior year audit finding (2004-1).”

The CPAs recommended that the State continue to monitor the status of these required audit reports and provide technical assistance to ensure that management and

the governing bodies of the borrowers understand the importance of filing timely audit reports. No costs were questioned by the CPAs as a result of this finding.

During the on-site review, EPA reviewed the State's corrective action plan to address these findings. EPA is satisfied that the State's actions have improved sub-recipient audit compliance and will continue to improve compliance with the OMB A-133 sub-recipient audit requirements.

The FY 2005 DWTRF set-aside costs were not included in a separate FY 2005 audit; however, the FY 2005 West Virginia Statewide Single Audit has been issued. It included finding 2005-1 (2005-36 in the Single Audit) and BPH's corrective action plan. The Single Audit covers both set-aside and project loan expenditures. Total Federal expenditures for the DWTRF program identified in the Single Audit were \$3,965,791.

Since the issuance of the EPA 2004 PER, the West Virginia FY 2004 Statewide Single Audit has been issued. It contained the audit finding that was noted in the FY 2004 DWTRF audit (2004-1) regarding sub-recipient audits that have not been received on time; however, the DWTRF was not included in the FY 2004 West Virginia Statewide Single audit as a major program.

SET-ASIDE ACCOUNTING AND INTERNAL CONTROLS

The FY 2004 PER recommended that BPH prepare FY 2004 financial statements for the set-asides and certify that the amounts reported for each set-aside agree with the amounts reported in the statewide FY 2004 audited financial statements. As noted above, BPH did not have an audit performed on the FY 2005 set-aside costs incurred, nor was an audit performed for the FY 2004 set-asides.

The separate set-asides audit is not legally required under the 1996 amendments to the Single Audit Act; however, the set-asides were included in the FYs 2004 and 2005 West Virginia Statewide Single Audits.

To assure that BPH and DHHR are properly recording allowable set-aside costs to the DWTRF grant, EPA assessed BPH's accounting and reporting of set-aside costs incurred during the annual review.

BPH has established separate fund accounts for each set-aside activity (as well as for the loan projects). EPA testing of selected set-aside disbursements disclosed that BPH has a good accounting and financial reporting system to properly report eligible grant costs.

In addition, the 2004 PER recommended that BPH determine the correct payroll and related costs based upon time charges on staff time sheets and allocate all charges to the correct funding sources as soon as possible.

EPA did not test any DWTRF payroll and related charges for BPH staff members for FY 2005. Instead, payroll charges were selected from the EPA 3% Construction Management grant for review. EPA found that all payroll charges for BPH staff who allocated their time to the DWTRF and to the 3% grants were correct. EPA also found that the DWTRF and 3% grants were properly charged for their respective shares of the selected BPH staff time.

FINANCIAL CAPABILITY

As of June 30, 2005, the State had closed 28 DWTRF loans totaling \$38,434,758, of which \$29,663,006 was outstanding as loans receivable. EPA assessed the State's procedures for performing credit analyses of the borrowers prior to loan closing. In addition, EPA assessed the State's system for monitoring the continued financial strength of municipal borrowers during the loan term to assure continual repayment.

EPA reviewed the State's procedures and how they were applied to two projects totaling \$1,200,000 for Cowen PSD.

EPA found that the State has an effective system for performing initial credit analysis and assessing loan security proposed by loan applicants. The loan terms in the loan agreements for Cowen PSD were consistent with State policies and the results of the initial financial reviews performed. In addition, BPH performed a detailed study of the technical, financial, and managerial capability (TFM) of Cowen PSD to comply with SDWA, and found that it has the TFM required.

LOAN MONITORING

EPA reviewed the State's loan compliance monitoring program procedures and found that it has an effective system. It is a multi-faceted approach involving a review of the Municipal Bond Commission (MBC) collection reports on each of BPH's loans; the annual budgets of all borrowers; and annual financial statement audits for all of these borrowers. In addition, required single audits are reviewed and any findings and recommendations are resolved.

Of particular interest are the State's requirements that most projects receiving assistance from the State be reviewed by, and receive a certificate of convenience and necessity from, the Public Service Commission prior to loan closing. In addition, the State uses the MBC as the collection agent on all loans. The State's rate coverage and debt service reserve requirements reduce the likelihood of delinquencies or loan defaults.

To determine how well the State is maintaining its loan monitoring system, EPA selected the following four loans for review:

Loan Monitoring File Review			
Borrower	Project No.	Amount	Quarterly Payment
New Haven PSD	98DWTRF010	\$1,241,000	\$10,342
Danville PSD (Boone Co.)	99DWTRF006	1,846,000	17,750
Town of Delbarton	99DWTRF005	232,200	2,150
Town of Franklin	00DWTRF030	2,064,746	21,072
Total		\$5,383,946	\$51,314

Of the four borrowers selected above, only two had provided audits for FY 2004, which is the most recent completed fiscal period for which audits were required. WDA reviewed the audits received for Boone County and Town of Franklin and completed the audit checklists.

EPA's review of the completed checklists, follow-up correspondence, and other reports found that the State is maintaining an effective monitoring system of DWTRF borrowers. The one area in need of improvement is in the timely collection of required financial audits as discussed under the "Audit of the Fund" section above.

DISBURSEMENTS AND COLLECTION OF LOANS RECEIVABLE

EPA reviewed BPH's (and WDA's) loans receivable and collections to determine whether:

- Disbursements were properly added to the loans receivable balances;
- Principal and interest collections were deposited into the DWTRF in a timely manner and for the proper amounts as determined by the note or bond document; and
- Transactions were properly recorded in the DWTRF loan accounting system.

EPA tested three loan disbursements for the borrowers listed below, of a total of \$4,117,038 in FY 2005 DWTRF loan disbursements:

Disbursements File Review			
Borrower	Loan No.	Date	Total Disbursements
Town of Franklin	00DWTRF030	1 st Quarter	\$219,206.42
Mason Co. PSD	99DWTRF018	2 nd Quarter	121,289.61
Town of Bath	00DWTRF004	3 rd Quarter	1,369.30
Total			\$341,865.33

The review found that these disbursements were posted for the correct amounts to the DWTRF loan accounting system in a timely manner.

In addition, EPA reviewed loan principal and interest collections for the following borrowers:

EPA Loans Reviewed for Collections			
Borrower	Principal	Interest	Total
New Haven PSD	\$10,342.00	\$0.00	\$10,342.00
Boone Co.	17,750.00	0.00	17,750.00
Town of Franklin	21,071.86	0.00	21,071.86
Town of Delbarton	2,150.00	0.00	2,150.00
Total	\$51,313.86	\$0.00	\$51,313.86

All transactions were posted to the loans receivable accounts for the correct amounts as prescribed in the bonds and amortization schedules governing these agreements. In addition, EPA found that all of the selected principal repayments (all of the loans were for 0% interest) had been properly deposited into the DWTRF in a timely manner.

On the basis of its review, EPA concludes that BPH has an effective system for properly accounting for and controlling loan disbursements and repayments.

EPA noted that all of the above selected loans had deficit balances in their revenue or reserve accounts held by MBC; however, WDA contacted each of these borrowers to assure that all payment deposit deficiencies will be corrected. None of these deficiencies resulted in delinquencies or defaults in any repayments due to the DWTRF.

OBSERVATIONS GRANT COMPLIANCE AREAS REVIEWED

PAYMENTS

Consistent with the payment schedules in the grant agreements, during FY 2005 EPA released and the State accepted Federal payments totaling \$8,000,984 from the Automated Standard Application for Payments (ASAP) account. Of this amount, \$5,556,225 was for projects and \$2,444,759 was for set-asides. Cumulative payments as of June 30, 2005, totaled \$52,603,454: \$38,324,626 for projects and \$14,278,828 for set-asides.

STATE MATCH

BPH met the 20% state match requirement for projects. Based on cumulative Federal payments as of June 30, 2005, the required match was \$10,148,500. As of June 30, 2005, the State had deposited \$11,749,320 into the Fund, as shown in the State's FY 2005 Annual Report. This agrees with the amount reported in DWNIMS.

Under the Program Management set-aside, BPH was required to provide \$1,269,756 in state match funds based on disbursements made during FY 2005. The State provided \$1,269,756 as shown in the State's FY 2005 Annual Report. This agrees with the amount reported in DWNIMS.

BINDING COMMITMENTS

Total BCs required as of June 30, 2005 were \$48,473,126 based on Federal grant payments of \$38,324,626 and state match of \$10,148,500. Actual BCs as of June 30, 2005 were \$54,310,435. The difference between the required and actual amount is \$5,837,309. The State complied with the BC requirement for each quarter of FY 2005. EPA commends the State for making great strides in meeting the BC compliance requirement.

FINANCIAL STATUS REPORTS

BPH reported \$4,045,272 in Federal outlays on the FSRs submitted for the reporting period July 1, 2004 to June 30, 2005. The amount of net disbursements reported on the FCTRs were \$3,972,603.17. The difference of \$72,668.83 between the two reports occurred because the State counted indirect costs of \$72,668.13 that were

accrued costs. These funds, however, were not drawn until State FY 2006. EPA was able to reconcile the difference between the two reports.

FEDERAL CASH TRANSACTION REPORTS

The State's FCTRs showed capitalization grant receipts of \$3,901,376.21. This amount reconciles to EPA's grant payment records. BPH also reported net disbursements of \$3,972,603.17; this amount does not agree with the expenditures reported in the FSRs (\$4,045,272). See explanation given in the "FSR" section for the \$72,668.83 difference.

ADMINISTRATIVE COSTS

BPH disbursed \$245,292 in administrative expenses against the capitalization grants during FY 2005. Cumulative administrative costs expended as of June 30, 2005 total \$1,585,319, representing 2.70% of the total capitalization grants awarded to BPH. This is within the 4% ceiling set by the SDWA.

DRINKING WATER NATIONAL INFORMATION MANAGEMENT SYSTEM

EPA commends BPH for submitting the DWNIMS data in a timely and efficient manner.

Effective with the FY 2005 DWNIMS data collection effort, EPA broadened the definition of compliance from one category to four. States are now being asked to classify compliance data into the following four subcategories:

- (1) Assistance to bring a system out of compliance back into compliance;
- (2) Assistance to compliant systems to maintain compliance with SDWA;
- (3) Assistance to achieve compliance with future drinking water requirements;
and
- (4) Other assistance to a system for any other activity (such as water line extensions or consolidation).

During the annual review, EPA and BPH discussed the completeness of the State's compliance data reported in DWNIMS. During the FY 2005 DWNIMS reporting period, BPH reported 16 of 28 loans closed for non-compliant systems. The compliance category for the remaining 12 loans was not specified.

Accurate compliance data in DWNIMS is important for two reasons:

- (1) Compliance is one of the three major components of state ranking systems and
- (2) Compliance is a new EPA DWSRF Program Activity Measure. As such, compliance data will be widely used to demonstrate the effectiveness of the program.

EPA requests that BPH identify the compliance purpose for all remaining DWTRF loans.

Action Items: BPH will enter data for all compliance categories for all DWTRF loans, both for the current reporting cycle and for all loans made in past years, no later than the FY 2006 DWNIMS data entry period.

ANNUAL REPORT

Although the State's OA with EPA requires Biennial Reports, the State has been submitting Annual Reports. BPH submitted its Interim Annual Report on October 21, 2005 after EPA approved the State's request for an extension. The report complied with SDWA, DWSRF regulations, and Region III Supplemental Guidance and included:

- All of the required compliance statements;
- Complete and accurate financial charts; and
- A description of how the short-term and long-term IUP goals were fulfilled.

The Annual Reports facilitate discussion during the on-site review. EPA commends BPH for reporting more frequently than is required.

RECOMMENDATIONS

ACTION ITEMS FOR BPH

The following is a list of items identified throughout the report for State action:

1. BPH shall include one or more success stories in future Biennial/Interim Annual Reports. (Page)
2. BPH shall prepare a brief report which: (1) analyzes the factors which impact the pace of loan execution and the fund utilization rate and (2) identifies recommendations to improve performance. (Page)
3. In accordance with the EPA Regional supplemental set-aside guidance, the State's future set-aside workplans will include schedules and budgets for each activity over a period not to exceed four years. (Page)
4. In accordance with the EPA Regional supplemental set-aside guidance, the State will compare actual set-aside expenditures and deliverables to projections included in DWTRF set-aside workplans. The State shall include this analysis in future drinking water semi-annual progress reports and DWTRF Interim Annual/Biennial Reports. (Page)
5. BPH shall confirm the cumulative amounts obligated and expended for the Program Management set-aside as of June 30, 2005. (Page)
6. BPH will enter data for all compliance categories for all DWTRF loans, both for the current reporting cycle and for all loans made in past years, no later than the FY 2006 DWNIMS data entry period. (Page)

ACTION ITEMS FOR EPA

The following is a list of items identified throughout the report for EPA action:

1. EPA will review BPH's proposed amendments to the OA. (Page)
 2. EPA shall revise and release the supplemental Regional set-aside management guidance. (Page)
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PRIOR YEAR ACTION ITEMS

ACTION ITEMS FOR BPH

1. BPH should continue to identify ways to accelerate the loan application and closing process.
In process. BPH's first step has been to revise the PPL development process.
2. BPH will consider approaches to reduce project bypasses including: (1) revising its process for developing the DWTRF project priority list, (2) improving the readiness of projects to proceed (e.g., additional technical assistance, streamlining co-funding approval procedures) and (3) addressing project affordability.
Ongoing.
3. In its Annual Report, BPH shall more clearly describe the status of bypassed projects and the efforts the State is making to assist the projects move forward.
Resolved. Projects were bypassed because other funding was sought.
4. BPH should provide EPA a plan to ensure compliance with the six affirmative steps, particularly with respect to applying these steps to the procurement of services. This plan should be submitted to EPA within 60 days of receipt of EPA's DBE guidance.
Resolved.
5. BPH shall prepare a brief report which: (1) analyzes the factors which impact the pace of loan execution and the fund utilization rate and (2) identifies recommendations for how to improve performance. If desired, BPH may request assistance from EPA.
On-going.
6. BPH will prepare FY 2004 financial statements for the set-asides and certify that the amounts reported for each set-aside agree with the amounts reported in the statewide FY 2004 audited financial statements.
Resolved.
7. BPH will determine the correct payroll and related costs based upon time charges on staff timesheets and allocate all charges to the correct funding sources as soon as possible. BPH will continue to perform timely allocations of these charges.
Resolved.

8. BPH must reconcile amounts reported on the FCTRs with amounts reported on the FSRs.
Resolved.
9. BPH must reconcile information in the FCTRs with its FSRs, DWNIMS, and the State's Annual Report.
Resolved.
10. DHHR must draw Federal funds from ASAP based upon actual expenditures incurred and invoiced by BPH. In addition, DHHR must reconcile the cash balances in ASAP to official State accounting records monthly, and provide this reconciliation to BPH.
Resolved.
11. The State will report closed loans and BCs to EPA on a quarterly basis.
BPH reported the status of BCs for all four quarters of FY 2005.

ACTION ITEMS FOR EPA

1. At the request of BPH, EPA will provide sample guidelines and criteria regarding principal forgiveness and assist the State in understanding the potential impact on using the additional subsidy on the long-term financial viability of the Fund.
Ongoing.
2. EPA will review BPH's proposed amendments to the OA.
EPA will complete by September 30, 2006.
3. EPA will provide guidance to BPH regarding options for complying with the DBE six affirmative steps.
Completed.
4. EPA will, if requested, work with BPH to develop possible solutions to the DBE compliance issue.
Ongoing.